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EXECUTIVE COMPENSATION '89:
How CEOs evaluate, review, and reward their key people
see page 74

SEPTEMBER 1989
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WHO'S *REALLY* FINANCING AMERICA'S START-UPS?

Meet the People Who Are Putting the 'Venture' Back in Venture Capital

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DEALS:
advanced technology, alternative energy
TYPICAL INVESTMENT:
$1 million to $20 million

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FOUNDER:
Soho Natural Soda
DEALS:
printer, film distributor, real estate
TYPICAL INVESTMENT:
$100,000 to $250,000

PHILIP ROMANO, 49
FOUNDER:
Fuddruckers restaurant chain
DEALS:
medical technology, men's clothing
TYPICAL INVESTMENT:
$100,000 to $200,000

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EXECUTIVE COMPENSATION 1989

How CEOs evaluate, review, and reward their key managers and employees

BY BRUCE G. POSNER

It isn't difficult to explain the widespread interest in questions of compensation. Founders of growing companies often lack a context in which to measure their own company's compensation practices and policies. And, more personally, who doesn't like to know how their own paycheck ranks in the larger scheme of things?

With our annual survey on executive compensation, INC. has attempted to satisfy this curiosity since 1979, our first year of publication. Throughout this period, we've published hard numbers on what chief executive officers of private companies pay themselves and their top people, along with details on benefits and perks—their bonuses, the cars they drive, and who gets to fly first class.

This year we've added a new dimension to our compensation package. To keep up with the information needs of people who are running businesses, we're furnishing more data than ever on companywide pay practices. We're also providing material on how executives go about making the nitty-gritty decisions that shape their overall pay strategies. How, for example, do they review employees? Are salaries kept secret? Who makes the final decisions about earnings?

You'll find the answers to these and other questions on the pages that follow.

THE TAKE AT THE TOP

A look at how CEOs fare in salary, bonuses, benefits, and perks. And what their top executives make based on industry and size of company.

CEO BENEFITS AND PERKS

Company car & expenses	80%
Supplemental life insurance†	57
Tax-return preparation	48
Club dues & expenses	39
Supplemental medical insurance†	36
Personal tax & financial planning	28
Low- or no-interest loans	24
Supplemental retirement benefits†	17
Deferred compensation	13
First-class air travel	10
Moving allowance	9
Housing allowance	5

†Beyond customary companywide benefits

THE CEO: A profile of the typical chief executive officer

Total compensation	$104,802
Base salary	$78,161
Percent receiving bonus	49%
Bonus	$49,028
Bonus as a percent of total compensation	29%
Age	46
Equity held	67%
Percent with no equity	5%
Percent who are founders	74%

THE COMPANY: A profile of the typical company

Total revenues (FY 1988)	$6,774,008
Number of employees (FY 1988)	104
1988 payroll	$1,452,636
Payroll as a percent of revenues	29%
Percent that are privately owned	94%

All figures are averages.

How can you tell if the size of your payroll is right for the type of business you're in?

Patterns do emerge from our survey. For example, the percentage of sales that the median wholesale and retail companies devote to salaries, wages, and other forms of compensation is only about half that of manufacturing and service businesses. Wholesalers, as a group, tend to pay out the least (13.2%), while service businesses pay the most (35.6%).

Since small, growing companies are often in specialized niches, however, the relationship between payroll and revenues depends on a number of factors—everything from the nature of the market to plans for expansion.

If industry comparisons aren't relevant, is there anything else you can look at?

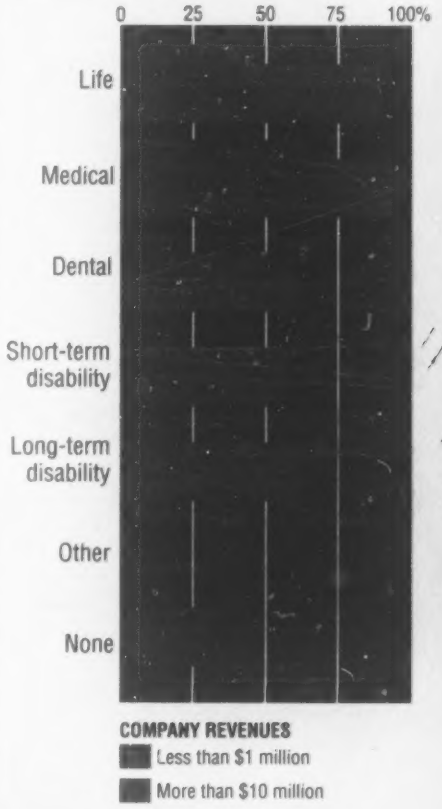
Company size. But it, too, is a weak indicator. Bigger companies—more than $10 million in revenues—often spend a much smaller percentage of their resources on payroll than smaller ones, but beyond that, there's little the survey points up. There are huge variations among similar-size companies. Many $2-million businesses, for instance, have payrolls of less than 20% of revenues, while others pay out in excess of 50%; the median for all the businesses we surveyed is 27%.

Benefits are an ongoing issue. How can a company tell whether it's in the ballpark?

Interesting clusters show up in the survey within industries and by size. Manufacturers, for example, tend to devote the highest percentage of their payroll to benefits; retailers spend the least. The median manufacturing business spent 10.2% of payroll on assorted benefits in 1988; the median retailer, 5.6%. Service and wholesale companies fell in between.

As for size, the bigger the business, the more benefits it offers. Of surveyed companies wtih revenues of more than $10 million, over 90% offer life and medical insurance, and about 60% offer dental and short- and long-term disability coverage (see figure 1). *(continued)*

FIGURE 1
COMPANYWIDE BENEFITS
% offering group insurance



TOTAL COMPENSATION FOR TOP OFFICERS BY COMPANY SIZE

$10 million or more

Sector	CEO	COO	CFO	CMO*
Service	$220,453	$130,014	$91,237	$128,003
Manufacturing	183,975	110,397	87,799	94,867
Distribution	153,489	98,927	79,318	85,765
Retail	141,644	96,120	73,767	73,883
Overall	189,043	112,840	85,928	101,433

$1 million to $4.99 million

Sector	CEO	COO	CFO	CMO*
Service	$132,508	$76,517	$54,496	$72,135
Manufacturing	100,085	56,496	48,460	52,346
Distribution	91,737	54,737	43,896	53,840
Retail	72,670	50,817	35,706	53,773
Overall	108,449	65,720	51,880	60,447

$5 million to $9.99 million

Sector	CEO	COO	CFO	CMO*
Service	$198,947	$120,538	$130,043	$150,988
Manufacturing	144,289	81,815	54,448	77,761
Distribution	107,609	77,892	62,767	60,837
Retail	131,015	80,822	53,375	88,750
Overall	153,694	93,782	82,829	91,491

*Chief marketing or sales officer

Less than $1 million

Sector	CEO	COO	CFO	CMO*
Service	$61,443	$45,554	$39,378	$42,081
Manufacturing	47,723	33,923	27,820	38,279
Distribution	36,589	30,000	24,200	51,025
Retail	34,530	28,964	26,239	33,742
Overall	54,874	41,241	36,655	42,274

All figures are averages.

CHARTS BY: ELLEN TIKKANEN

What about companywide retirement benefits?

Companies surveyed offered retirement benefits to a greater extent than we expected. It's no surprise that fewer very small companies—those with revenues under $1 million—offer benefits than bigger ones, but a third of these small companies do have some kind of retirement plan. Younger companies—under five years old—are less inclined to have programs in place than their older counterparts. But we found plenty of exceptions. One was AMS Inc., a year-old multilevel marketing company in Oklahoma City, where several of the 10 full-time employees are being offered stock options. "For us, it's a way of preserving cash," president Dennis Loney says, "and we hope it generates loyalty."

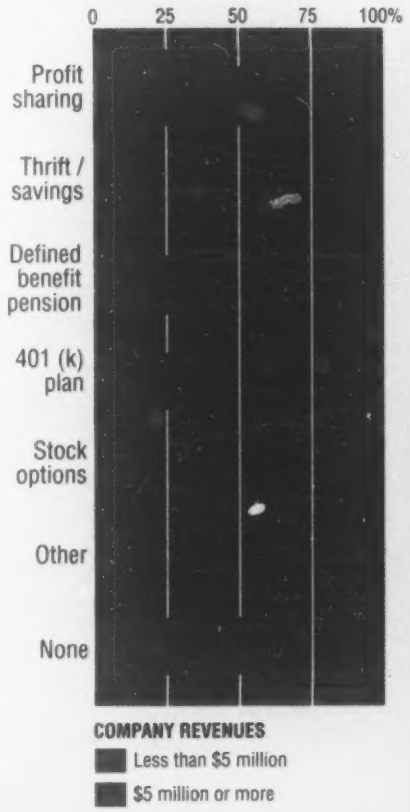
Once businesses pass the $1-million mark, retirement benefits such as profit sharing, 401(k) savings plans, and stock options become more common. About 80% of all companies we surveyed with sales of at least $5 million offer retirement benefits of some kind, and many offer more than one (see figure 2).

How common are employee performance appraisals or reviews?

Performance appraisals are a lot more embedded in the small-business culture than we had imagined. Of course, at companies with few employees, many executives complain that performance reviews are too formal. Typical are the comments of Robert Jordan, cofounder and CEO of International Demographics Inc., a 10-person business in Houston. "At our company," Jordan says, "communication is an ongoing thing." He experimented with employee appraisals several years ago but found them too cumbersome. "We like to confront problems whenever they come up," he says.

Still, half the executives at companies with sales of less than $1 million say they have companywide reviews. And the proportion grows as companies get larger: 82% of the companies with sales of $5 million and more say they conduct reviews. Nor do performance reviews appear to be one of those management fads that come and go. No matter what business they're in, most managers tell us they've been doing reviews for four years or longer. *(continued)*

FIGURE 2
COMPANYWIDE BENEFITS
% offering retirement benefits



THE TAKE AT THE TOP *(continued)*

DETERMINING BONUS AND SALARY FOR TOP OFFICERS

Companies paying bonuses	65%
Basis for allocation of bonuses*	
Discretionary	59%
Achievement of profit goals	32
Achievement of sales goals	27
Percent of profits	26
Percent of sales	10
Return on equity, assets, or sales	9
Companies with a bonus pool	65%

*Total exceeds 100% because of multiple responses. **Total exceeds 100% because of rounding off.

Basis for determining the size of bonus pool**	
Discretionary	62%
Fixed formula	17
Formula set annually	16
Other	6
Basis for increasing executive salaries*	
Company performance	59%
Discretionary	52
Individual performance	38
Cost of living	12

THE FACTS BEHIND THE FIGURES

This is the eleventh consecutive year that INC. has conducted an executive compensation study. In April we mailed a four-page questionnaire covering salaries, benefits, bonuses, practices, and policies to a random sample of 20,000 subscribers. Data Tabulation Services Inc., in Stoneham, Mass., compiled the 1,126 usable returns.

A special report containing the complete results of the survey is available. The report—while preserving the confidentiality of the survey responses—provides detailed information not included in this article. To obtain a copy, please fill out the postpaid card bound in this issue, or send a written request and a check for $98 ($95, plus $3 shipping and handling) to 1989 INC. Executive Compensation Study, P.O. Box 68618, 6360 LaPas Trail, Indianapolis IN 46268, or call (800) 372-0018, extension 3400.

The survey was conducted under the direction of special projects editor Sara Baer-Sinnott. Research assistance was provided by Teri Lammers.

Who generally does the reviews? And are they oral or written?

Among the companies in our survey, reviews are occasionally done by committees or by an employee's peers. But mostly managers and CEOs conduct reviews, and the involvement of CEOs is fairly consistent across industries. There are differences by company size. In those with sales of less than $1 million, for example, 66% of the CEOs are involved in companywide reviews. By the time companies pass the $10-million mark, CEO involvement drops to 27%. By then most of the responsibility for the appraisals shifts to managers; at $10 million, their involvement rises to 90%, up from 49% in companies with revenues of under $1 million (see figure 3).

There's a good deal of consistency, too, in how the reviews are conducted. Companies with sales of under $1 million are less inclined to commit themselves to paper; 34% do nothing in writing, compared with 25% of the companies overall. But a surprising number of executives—61%—said their reviews were both written and oral.

What topics are usually covered in performance reviews?

To some extent, the answer to this question is a function of a company's size and its stage of development (see figure 4). Virtually everybody who does reviews uses them to examine employee strengths and weaknesses. And most companies (around 80%) use them to adjust salaries, award bonuses, and frame goals for the coming year.

Smaller companies, though, tend to deal with broader issues. Instead of just focusing on individual employees, businesses with sales of less than $5 million also like to discuss company goals and problems—far more so than larger companies. One of these is Teletech Resources Corp., a $2.1-million business-communications company in Milwaukee. "We don't want people to see things too narrowly," explains Lucy Kugler, a Teletech vice-president. "Reviews are a great setting for talking about where we're going."

How often do companies hold reviews?

It depends on the industry. Retail businesses as a group tend to review employees more often than others—26% of the retail respondents say they do appraisals quarterly, compared with 12% in other businesses. And smaller companies—those with revenues of less than $1 million—also lean toward more frequent sessions; a quarter say they do them four times a year. The founder of an 11-person video-production business in Honolulu probably echoes the view of many of these companies when he says, "We feel that people can operate better with timely feedback."

Generally, however, an annual review is the norm, particularly as businesses get larger. At companies with sales of $10 million and more, 89% perform reviews annually, compared with 63% of those with revenues of less than $1 million.

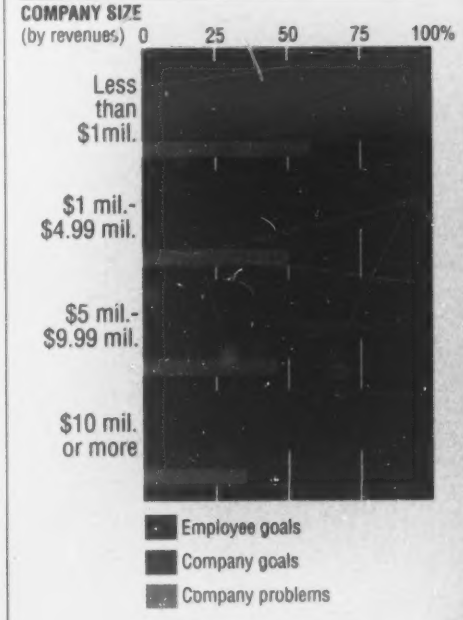
Are the reviews just for employees, or do managers get something out of them, too?

An astonishing 98% of those who conduct reviews say they find the process beneficial. The benefits are often hard to quantify, but in addition to providing a forum for communication about performance, they provide opportunities to hear about what's wrong (or right) about a business. "Things come up in these sessions that wouldn't come up in day-to-day discussions," says Bill Bozeman, CEO of Delta Audio-Visual Security Inc., a New Orleans–based electronic-security contractor. "Somebody will say, 'Isn't it time to consider this or that,' and it will set things in motion." In fact, Bozeman notes, comments during a recent review led Delta to restructure its service department.

(continued)

FIGURE 3
COMPANYWIDE PERFORMANCE REVIEWS
% conducted by CEO or manager

FIGURE 4
COMPANYWIDE PERFORMANCE REVIEWS
Topics covered (by %)



Do managers find doing reviews stressful?

You bet. Half of our respondents do, in fact. The most interesting comparisons are based on size. Although the stress levels are roughly the same for all industries—be they service, manufacturing, distribution, or retail businesses—they seem to become more intense as companies get bigger. So don't expect things to get easier as your company grows (see figure 5).

Are there ways to reduce the stress?

We've talked with managers who have suggestions for their colleagues who are uncomfortable with the idea of a one-sided conversation that puts employees on the spot. Dan Juhl, for instance, president and CEO of Stanhope Products Co., a supplier to the home-appliance and automotive industries based in Brookville, Ohio, overcomes this by inviting people to talk about how the company can do things better. "They know they can bring up anything that concerns them," he says. And before offering his own comments, Juhl asks employees to tell him how they think they've been performing. "Nine times out of 10," Juhl says, "they're harder on themselves than we would be." His role, at that point, is not to be critical, but to communicate standards he wants them to meet for the upcoming period.

How about confidentiality? Do employees know what others make?

Officially, they don't, and most CEOs would prefer to keep it that way. There's no question that rumor mills churn away at companies, but most of our respondents prefer that to releasing compensation information. Opening the books, says Larry Brown, CEO of Onions Inc., a restaurant operator in Spokane, Wash., would be a violation of people's privacy. "People would

FIGURE 5
COMPANYWIDE PERFORMANCE REVIEWS
Is process stressful for reviewers?

sit around and wonder why others were making so much," he says.

But not everyone thinks that distributing pay information is bad—or as bad as the rumors. A number of companies (13% of those we surveyed) make salary *ranges* available to anyone who asks, and 19% say they give employees the actual numbers.

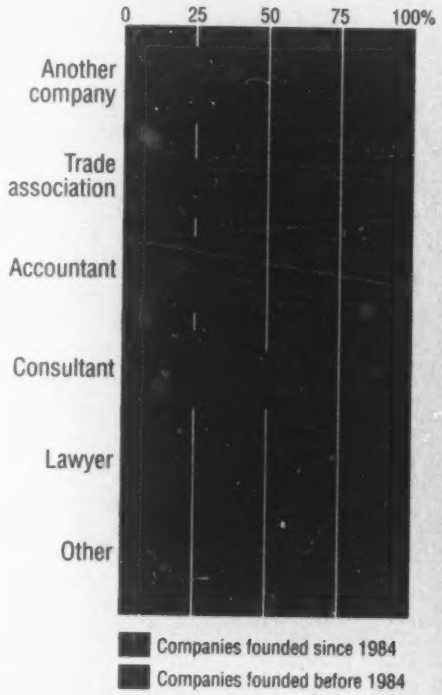
What do executives know about one another's compensation?

They know a lot more about what their colleagues are paid than do employees. Close to half of the executives we surveyed said salaries were known, while another 8% said only the salary ranges were known. In manufacturing businesses, information about executive pay is more restricted. Bigger companies, too, are less inclined to reveal these figures than smaller ones.

Do companies go to outsiders for help in sorting out compensation questions?

The bias entrepreneurs have against using consultants is legendary, so it isn't surprising that most of our survey respondents say they try to work things out for themselves. More than 70% say they've never gotten help from anyone. The executives least likely to look for help are those at retail and wholesale companies. People who have been in business for less than five years, no matter what the industry, are also less inclined to get help. At younger companies, for instance, only 22% had ever gotten assistance, compared with 32% of companies five years old and older. *(continued)*

FIGURE 6
OUTSIDE RESOURSES
Who provides help? (by %)



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Where do companies that want outside advice look for it?

Executives at younger companies are almost as likely to turn to their peers at other businesses as they are to call on consultants or accountants. In addition to being cheaper, it's a less formal way to get detailed information about how other people do things, notes John Thomas, CEO of Dakota Systems Inc., a $2.1-million fabricator of fluid- and gas-handling systems in Andover, Mass. Besides working with his accountant, Thomas has developed relationships with executives at two businesses similar to his own—one in Texas and the other in California. He's talked to them about everything from salary levels to profit-sharing options to the frequency of their performance reviews.

But the picture changes as companies get older and more established. Companies founded before 1984, for example, tend to rely more on traditional sources of advice, such as trade associations or consultants (see figure 6).

What are the main concerns of companies that seek help?

The smaller the company, the more interested it is in benefits. For businesses under $1 million, this ranks far ahead of every other concern. At larger companies, interest shifts to salary ranges—the eternal question of what to offer new hires and how to keep them once they've settled in.

As for different industries, the issues are spread evenly, with one major exception: retail businesses have a particularly keen interest in how to develop effective incentive plans.

How do companies decide how much to increase executive salaries?

The most common factor, logically enough, is how the business is doing. That's cited by 59% of the executives we surveyed, and it cuts across all industry and size categories. A somewhat smaller group of respondents (52%) says salary increases are decided at least partly on a discretionary basis; cost of living is far behind, at 12%.

The most interesting finding, however, has to do with the relative importance of individual performance. Among businesses with sales of less than $1 million, individual performance is cited just 27% of the time. But once sales reach $10 million or more, an executive's performance becomes a factor in nearly 60% of the companies.

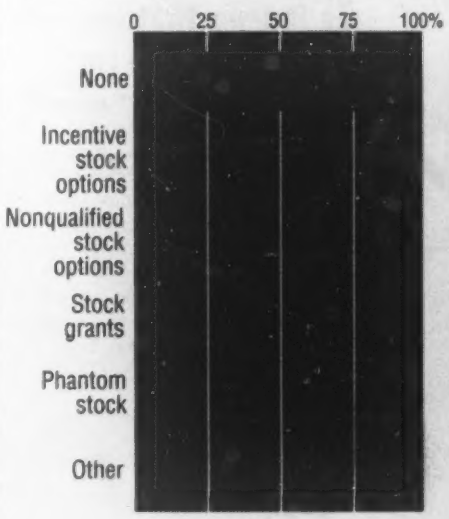
What about executive bonuses? How are they determined?

Sixty-five percent of the companies surveyed pay bonuses to executives, but despite all we hear about the trend toward "paying for performance," most businesses are still pretty informal about how they allocate bonuses. In fact, 59% of our respondents say the decision is at least partly discretionary. The process becomes more numbers-driven as companies get larger, but discretion remains substantial even after companies pass the $5-million mark (see chart, page 76).

Is it usually the CEO who makes the final decision on executive compensation?

In about 80% of the companies surveyed, CEOs have a big say in the decision. Some companies (12% overall), though, turn the decision over to managerial committees. At Macke Business Products Inc., a $22-million company in Rochester, N.Y., for example, the top four executives set their own salaries and those of the top dozen managers. Doing things this way gen-

FIGURE 7
EXECUTIVE COMPENSATION
% offering capital accumulation plans



erates a feeling of trust among managers, CEO Edward H. Fischer says. "If we were more arbitrary, it might undermine the team spirit."

Is it true that the use of executive stock options is on the rise?

Not according to our survey. In the four years we've been tracking stock options for executives, the levels have remained virtually flat. Incentive stock options, which provide opportunities for employee gains with no corresponding tax benefit to the company, are currently used at about 9% of the companies we survey. Nonqualified options, which do have potential tax benefits for employers, are used at around 3% (see figure 7).

What businesses are most apt to have stock options? Manufacturing companies and businesses with sales of more than $10 million; both groups tend to be a little more aggressive with their capital-accumulation programs. But 65% of the $10-million-plus companies we surveyed had nothing by way of a capital-accumulation plan, and the percentage of smaller businesses without plans was closer to 86%.

What guidelines do CEOs use to set their own compensation?

Because of the niches they operate in, many entrepreneurs don't think of themselves as being part of well-defined industries. That makes setting pay levels a little tricky, according to David Charles, president of BenchMark Environmental Services Group, a $10-million heating, ventilation, and air-conditioning service contractor based in Denver. With 97 employees and business in four states, BenchMark, Charles says, is set up quite differently from its competitors, which have fewer employees and operate in a smaller area. So, rather than using them as a comparison, he plays off owner-operators of service firms that are in situations more analogous to his own.

Even when industry comparisons are easy to find, some CEOs seem reluctant to give them too much weight. Louis Williams, president of L. C. Williams & Associates, a Chicago public-relations firm, for instance, says he pays himself less than owners of other firms his size. "Not that I don't like money as much as anyone," he says. "But as the owner, I look at things a little longer term. As the business becomes more valuable, I'll benefit."

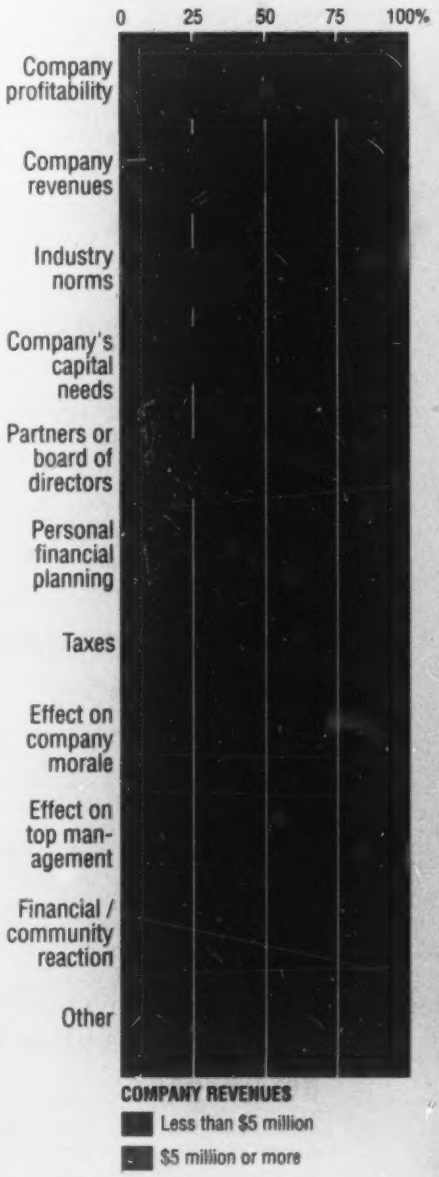
Overall, the largest number of CEOs in our survey said they based their compensation on profitability. Salaries and bonuses, on average, totaled $104,802. Executives at companies with sales exceeding $5 million were more likely to cite industry norms as a major factor than smaller businesses. And they were less likely to mention capital needs or taxes (see figure 8).

Are most CEOs satisfied with their compensation? Are there perks or benefits they'd like to have but don't?

We'll tell you what they told us. Only 3% of the CEOs we surveyed allowed that their 1988 compensation might be "too high" (nobody offered to give any of the money back). The least happy of them seemed to be concentrated in businesses with less than $1 million, where 58% said their pay was "too low," and in retailing (53%). Most CEOs (54%) indicated they were paid "about right." The most content? CEOs of wholesale or distribution businesses (61%) and companies with revenues of $10 million or more (68%).

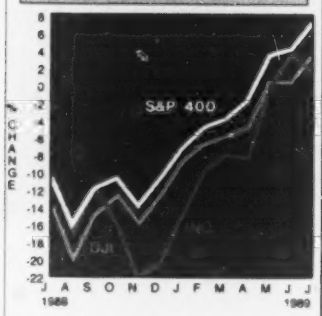
As for the extras, most CEOs are apparently well set. When asked what perks or benefits they'd like to receive and currently don't, 69% of the respondents left the question blank. And what about those who did answer? Fifteen percent said "none." For the others, it depends on what stage they're at. CEOs at companies under $1 million wanted the basics: cars (19%), health insurance (23%), or pensions (20%). But once sales exceed $5 million, the focus shifts; 12% wanted supplemental retirement benefits, and 12% mentioned country-club memberships. □

FIGURE 8
EXECUTIVE COMPENSATION
What CEOs consider when setting own compensation (by %)



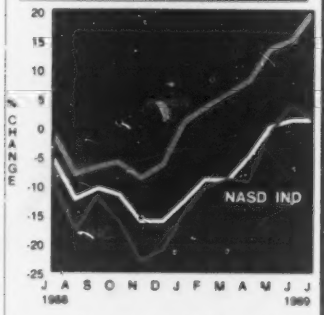
INVESTING IN GROWTH COMPANIES

INC. vs. CONSERVATIVE AVERAGES



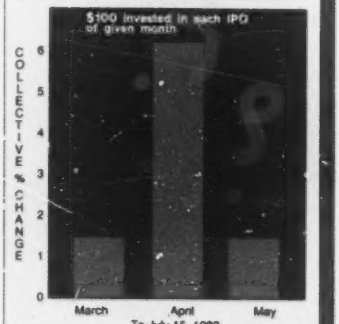
All averages start at 0 in October 1987.

INC. vs. SPECULATIVE AVERAGES



All averages start at 0 in October 1987.

IPOs IN THE AFTERMARKET



INITIAL PUBLIC OFFERINGS: JUNE 1989

O-T-C sym.	Company	Business/product	Offering Size ($mil.)	Offering Price	First aftermarket bid	Underwriter
AOT[a]	Allstate Municipal Income Opportunities Trust II	Closed-end fund	185.00	10.00	10	Dean Witter
SALIU	Bali Jewelry Ltd.	Mfrs. gold jewelry	5.00	2.50[c]	2⅞	J. W. Gant
BNSUF	Bonso Electronics International	Mfrs. electronics products	10.00	5.00[d]	5	Blinder Robinson
CRUS	Cirrus Logic	Mfrs. semiconductors	33.40	10.00	12⅜	Goldman Sachs
COKR	Cooker Restaurants	Restaurant chain	18.00	4.50	4⅝	Morgan Keegan
FISE	First Indiana	Savings & loan	5.45	12.25	12¼	Merrill Lynch
FRCH	Frenchtex	Distr. European textiles	3.41	5.25	5½	Keane
HAND	Handex Environmental Recovery	Provides groundwater-testing svcs.	16.80	14.00	14¾	Alex. Brown
IEX[a]	IDEX	Mfrs. industrial pumps	47.85	14.50	14½	Bear Stearns
ICTIU	International CMOS Technology	Dvlps. semiconductors	3.60	5.00[e]	5 1/16	Paulson Investments
MAG[a]	MagneTek	Mfrs. electrical equip.	63.00	12.00	11¾	Merrill Lynch
NPP[a]	Nuveen Performance Plus Municipal Fund	Closed-end fund	750.00	15.00	15	Alex. Brown
PCL[a]	Plum Creek Timber	Mfrs. timber & wood products	247.00	20.00	20¼	Shearson Lehman
REXL	Rexhall Industries	Mfrs. motor homes	6.00	6.00	6⅜	H. J. Meyers
SFD[a]	Smith's Food & Drug Centers	Regional supermarket chain	98.80	19.00	20½	Goldman Sachs
STXL	Sports-Tech International	Dvlps. computer products & systs.	2.50	5.00	5⅜	Gulfstream
SYMC	Symantec	Dvlps. microcomputer software	16.48	10.50	11½	Robertson Colman
SNTC	Synetic	Mfrs. plastics	18.90	10.50	10⅞	Drexel
TCM[b]	T/SF	Publishing & communications	25.20	12.00	12	Oppenheimer
WS[a]	Weirton Steel	Mfrs. steel	58.00	14.50	14⅞	Lazard Freres

Initial public offerings sold at $1 or less not included. First aftermarket bid is approximate. [a] trading on NYSE; [b] trading on AMEX; [c] units of 1 common + 1 warrant; [d] units of 5 common + 5 warrants; [e] units of 2 common + 2 warrants. Offering data source: *Going Public: The IPO Reporter*, a publication of The Dealer's Digest Inc., 150 Broadway, New York NY 10038.

STREET TALK Investors in small-cap stocks no doubt were unpleasantly surprised by the two-percentage-point decline in the INC. index in the 30 days reported on this page, especially inasmuch as the DJI and S&P sprang ahead three percentage points to new post-Crash highs. In large part, INC.'s malaise can be attributed to a poorly performing technology sector, in which many small computer companies (not to mention such big ones as Cray Research and DEC) dropped out of the overall bullish trend. Reading this sorry performance as a leading indicator of sorts, perhaps it means that capital spending is about to contract, and those predicting a recession next year have grounds for concern. *—Robert A. Mamis*

CHARTS: IMAGEBUILDER DESIGN

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